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No. 99-387

Supreme Court, U.S.
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In the

Supreme Court of the United States

THOMAS E. RALEIGH, Chapter 7 Trustee for the Estate of William J. Stoecker,

Petitioner,

v.

STATE OF ILLINOIS, DEPARTMENT OF REVENUE,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

BRIEF FOR THE RESPONDENT

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QUESTION PRESENTED

Whether the burden of proof that applies to government tax claims in state court—a burden that substantive tax law ordinarily places on the taxpayer to disprove his liability—is reversed and falls on the government when the government brings a tax claim in the bankruptcy court.

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STATEMENT OF THE CASE

1. Chandler Enterprises and Stoecker

William J. Stoecker was the president and a director of Chandler Enterprises, Inc., an Illinois corporation. (P.A. A-2, C-18).[1] Chandler's officers included Lawrence Pluhar, who also served as an officer of other corporations involving Stoecker. (B.R. vol. 4, J. Prewitt Dep., Ex. 2; B.R. 1992 Tr. at 125, 131). According to Chandler's counsel, Pluhar acted "like his [Stoecker's] chief financial officer." (B.R. 1992 Tr. at 125). Other than that single comment, there is no evidence of the duties Stoecker or Pluhar performed for Chandler. Nor is there any evidence about the nature of Chandler's business. The Illinois Secretary of State involuntarily dissolved Chandler in 1990. (P.A. E-4).

Chandler was one of many companies in a larger Stoecker business empire. (B.R. vol. 3, 1154A-B, Ex. C). A federal grand jury eventually indicted Stoecker and Pluhar for mail, wire and bank fraud in connection with these companies, alleging that Chandler and several other companies were mere shells with no substantial assets, value, income, or business operations. (*Id.* at 4). Stoecker and Pluhar were subsequently convicted. *United States v. William Stoecker, et al.*, No. 95 CR 118 (N.D. Ill.

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[1] The appendix to the petition for writ of certiorari is cited as "P.A." The bankruptcy court record is cited as "B.R." Because some items in the bankruptcy court record are not numbered, references to the record will cite to the volume and to the item number where possible. The 1992 hearing transcript (cited as "1992 Tr.") appears in volume 5.

March 4, 1997). Stoecker's appeal of his conviction is pending. *United States v. William Stoecker, et al.*, No. 97-3870 (7th Cir.).[2]

2. Chandler's Purchase of the Aircraft

In early 1988, Chandler decided to purchase a corporate jet and hired an aircraft broker to locate a jet for sale. (P.A. A-2). The broker found a Dassault Falcon 50 in the possession of an Australian company. (P.A. A-2, C-15).

Because Chandler was unable to pay the full $12 million purchase price, the broker's leasing company financed the sale on an interim basis, entering into an aircraft lease/purchase agreement with Chandler. (P.A. A-2). Stoecker signed the agreement as Chandler's president. (P.A. C-51). Chandler paid the leasing company $2.5 million and took delivery of the aircraft, transferring it to Illinois. (P.A. A-2). Several months later, Chandler obtained financing from NEMLC Leasing Corporation and paid the balance of the purchase price. (P.A. A-2-3, C-16). Title to the aircraft was transferred to Chandler. (P.A. A-3).

In connection with the purchase, NEMLC sought a legal opinion from Chandler about the taxability of the transaction under Illinois law. (B.R. 1992 Tr. at 125). Chandler's counsel wrote a letter to NEMLC opining that the sale was an "occasional sale" not subject to Illinois

[2] The Court can take judicial notice of related litigation. *National Fire Ins. Co. v. Thompson*, 281 U.S. 331, 336 (1930).

use tax. (P.A. C-16-17). Although a copy of the letter was sent to Pluhar and was also included in the closing book that Pluhar received (P.A. C-56; B.R. 1992 Tr. at 130-31), there is no evidence that Stoecker ever saw the letter (P.A. A-8). No opinion letter was issued to Chandler or to Stoecker himself. (P.A. C-55; B.R. 1992 Tr. at 136).

Following the closing, Chandler registered the aircraft with the Federal Aviation Administration at an address in Oak Forest, Illinois (B.R. 1992 Tr. at 33), but never registered it with the Illinois Department of Transportation, as Illinois law required, *see* Ill. Rev. Stat. ch. 15½, ¶ 22.42 (1989). (P.A. C-15). No certificate of registration could have been issued without proof either that Illinois use tax had been paid or that no tax was due. (P.A. A-12).

3. The Illinois Use Tax

The Illinois "sales tax" scheme consists of two taxes: a retailer's occupation tax, Ill. Rev. Stat. ch. 120, ¶¶ 440-53 (1989), and a use tax, Ill. Rev. Stat. ch. 120, ¶¶ 439.1-.22 (1989). The occupation tax is a tax "upon persons engaged in the business of selling personal property" in Illinois. Ill. Rev. Stat. ch. 120, ¶ 441 (1989). The use tax is a complementary tax "upon the privilege of using in this State tangible personal property," regardless of whether the property is purchased in Illinois. Ill. Rev. Stat. ch. 120, ¶ 439.3 (1989).

Unlike the occupation tax, the use tax is imposed on the purchaser of property. Retailers in Illinois, and foreign retailers with an adequate nexus to Illinois, must collect the tax and remit it to the Department. Ill. Rev.

Stat. ch. 120, ¶ 439.3 (1989). However, any tax "not paid to a retailer . . . shall be paid to the Department directly by any person using such property within this State." *Id.* Purchasers from a retailer who does not pay the tax must file a return with the Department and pay the tax themselves. Ill. Rev. Stat. ch. 120, ¶ 439.10 (1989).

If no return is filed, the Department determines the tax due and issues a Notice of Tax Liability ("NTL") to the taxpayer. Ill. Rev. Stat. ch. 120, ¶ 444 (1989). The taxpayer may protest the assessment and request a hearing. *Id.* If no protest is filed, however, the NTL becomes a final assessment. *Id.* Decisions of the Department, including final assessments, are subject to administrative review in the Illinois courts. Ill. Rev. Stat. ch. 120, ¶¶ 444, 451 (1989).

When a corporation fails to pay use tax it owes, responsible officers and employees of the corporation may be held liable for a penalty equal to the unpaid tax:

> Any officer or employee of any corporation subject to the provisions of this Act who has the control, supervision or responsibility of filing returns and making payment of the amount of tax herein imposed . . . and who wilfully fails to file such return or make such payment to the Department or willfully attempts in any other manner to evade or defeat the tax shall be personally liable for a penalty equal to the total amount of tax unpaid by the corporation, including interest and penalties thereon . . . .

Ill. Rev. Stat. ch. 120, ¶ 452½ (1989).[3] If the Department determines that a penalty should be imposed, the Department issues a notice of penalty liability ("NPL") to the officer or employee. *Id.* As with an NTL, the officer or employee subject to an NPL can seek an administrative hearing and pursue administrative review in the Illinois courts. *Id.*

Once the Department has issued an NPL to a corporate officer or employee, the NPL is deemed "prima facie correct" and "prima facie evidence of [the] penalty due." Ill. Rev. Stat. ch. 120, ¶ 452½ (1989). Upon proof of the NPL, the burden falls on the officer or employee to prove he is not liable for the penalty assessment. *Branson v. Department of Revenue,* 168 Ill. 2d 247, 659 N.E.2d 961 (1995). The burden is not merely a burden of going forward. In *Branson,* the Illinois Supreme Court held that the ultimate burden of proof shifts to the taxpayer. The NPL establishes "a rebuttable presumption" that is rebutted only if the taxpayer can "adduce sufficient evidence to *disprove* willful failure to file returns and pay taxes." *Id.* at 262, 659 N.E.2d at 968 (emphasis added).

4. The Department's Claim

Chandler filed no use tax return with the Department and paid no use tax on its purchase of the aircraft. (P.A.

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[3] This provision appeared in the Retailer's Occupation Tax Act and was incorporated into the Use Tax Act. Ill. Rev. Stat. ch. 120, ¶ 439.12 (1989). The provision was later repealed and recodified as part of the Uniform Penalty and Interest Act. 35 ILCS 735/3-7 (1994).

A-4, B-2). In fact, Chandler never filed Illinois tax returns of any kind and was not registered with the Department in any capacity. (P.A. C-18, D-3). The Department knew nothing of Chandler or the aircraft it purchased.

In 1989, Stoecker's creditors initiated an involuntary proceeding against him under chapter 11 of the Bankruptcy Code. (P.A. C-12). Thomas E. Raleigh was appointed trustee. (*Id.*). The proceeding was later converted to a liquidation under chapter 7, and in 1990 Stoecker was denied a discharge. (*Id.*).

In early 1989, the Department was notified about Stoecker's bankruptcy. (P.A. C-13). The Department's bankruptcy unit researched Stoecker and filed claims against him in the bankruptcy as the responsible officer of several corporations. (P.A. C-13-14, D-3, E-3). Because Chandler was not a registered taxpayer, however, the Department did not learn about Chandler or link Chandler to Stoecker and the bankruptcy. (P.A. C-14, D-3).

A year later, a Department auditor in a different unit was reviewing F.A.A. records for unreported aircraft purchases when he happened on Chandler's purchase of the aircraft. (B.R. 1992 Tr. at 14-15, 52). The Department initiated an audit of the aircraft purchase and sent several letters to Chandler asking about it. (P.A. C-17, D-3; B.R. 1992 Tr. at 26-27, and Dep't Ex. 4). The letters went unanswered. (P.A. D-3; B.R. 1992 Tr. at 27).

Later in 1990, the Department issued an NTL to Chandler assessing the unpaid use tax on the purchase. (P.A. A-4, B-2). Chandler filed no protest (B.R. vol. 2, 1576, ¶ 2), and the assessment became final by operation

of law, *see* Ill. Rev. Stat. ch. 120, ¶ 444 (1989). There is no evidence that Chandler sought administrative review of the assessment in the Illinois courts.

After the NTL was issued, the Department made numerous attempts to collect the tax from Chandler. The collector tried unsuccessfully to contact Chandler but determined that Chandler was out of business. (B.R. vol. 2, 1576, ¶ 34; B.R. vol. 6, Towers Dep. at 54). He also repeatedly tried reaching Stoecker and Pluhar, both in person and by mail. (P.A. D-3; B.R. 1992 Tr. at 74-76). Neither responded. (P.A. D-3; B.R. vol. 6, Towers Dep. at 59).

The matter was referred to the Department's NPL unit (B.R. 1992 Tr. at 76), which in June 1991 issued an NPL to Stoecker as a responsible officer of Chandler, assessing a penalty equal to the unpaid use tax. (P.A. A-4, C-19). The NPL was sent to Stoecker by certified mail but was returned unclaimed. (B.R. 1992 Tr. at 92). Stoecker filed no protest (*id.* at 93), and the penalty assessment became final by operation of law, *see* Ill. Rev. Stat. ch. 120, ¶ 444 (1989). There is no evidence that Stoecker sought administrative review of the penalty assessment in the Illinois courts.[4]

In September 1991, the NPL unit sent Stoecker a demand for payment of the penalty. (P.A. D-4). In response, Stoecker's counsel had several telephone conversations

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[4] The Department also issued an NPL against Pluhar. (B.R. 1992 Tr. at 92-93). Unlike Stoecker, Pluhar protested the NPL, and after an administrative hearing the Department found he was not a responsible officer of Chandler. (*Id.* at 93).

with the NPL unit. (B.R. 1992 Tr. at 94-96). It was not until a conversation in January 1992, however, that he revealed to the NPL unit that Stoecker was in bankruptcy. (P.A. C-20; B.R. 1992 Tr. at 95-98). On January 21, 1992, the Department filed a proof of claim in the bankruptcy for the penalty, a claim later amended to $911,769: $868,351 in unpaid use tax and $43,418 in pre-petition interest. (P.A. C-20-21).

5. Proceedings Below

The Trustee objected to the Department's claim (P.A. C-22, D-4), and in 1996, after extensive litigation, the bankruptcy court disallowed the claim (P.A. C-1-82), finding that the Department had not met its burden of proving Stoecker a responsible officer of Chandler (P.A. C73-74). The court admitted that the NPL was *prima facie* evidence of liability but determined that under Bankruptcy Rule 3001(f) the Trustee's only obligation was to present evidence sufficient to rebut the presumption the NPL raised. (P.A. C-5, C-46, C-73). At that point, the burden shifted back to the Department, which the court said bore the "ultimate burden of proof." (P.A. C-73). The bankruptcy court concluded that the Department failed to meet that burden.

The Department appealed the bankruptcy court's decision (P.A. B-1), and the district court affirmed. (P.A. B-1-21). The district court conceded that in non-bankruptcy proceedings "the taxpayer bears the ultimate burden of proof" but held that in bankruptcy the tax law burden of proof no longer applied. (P.A. B-7-8). Relying on *In re Macfarlane*, 83 F.3d 1041 (9th Cir. 1996), the

court reasoned that "[c]reditors should be treated equally with respect to the required burden of proof." (P.A. B-8). The Department, the court said, should not be able to benefit from a burden of proof that "arises outside of bankruptcy law." (P.A. B-8-9). The district court agreed with the bankruptcy court that the burden had shifted to the Department and that the Department had not met its burden. (P.A. B-9-12).

The Department appealed to the Seventh Circuit, and the Seventh Circuit reversed, holding that the burden of proof under tax law applied in bankruptcy proceedings. (P.A. A-1-13). The court observed that bankruptcy is simply "a forum in which creditors prove the entitlements that state or federal law confers on them" and in which "these entitlements are enforced consistently with the provisions of the Code." (P.A. A-9). Because burdens of proof are substantive law, they are "rightly classified as a part of the creditor's entitlement." (P.A. A-10). And although Congress "can alter entitlements in bankruptcy, and sometimes does so, there is no indication that it meant to shift the burden of proof from taxpayer to tax collector." (P.A. A-11).

The court acknowledged that bankruptcy is an "equitable procedure" (P.A. A-8) but rejected the notion—apparently accepted in *Macfarlane*—that bankruptcy is a kind of "equity free-for-all," one in which judges can curtail or expand the rights based on "their personal notions of fairness." (P.A. A-9-10). Bankruptcy courts, the court declared, have no authority to "cut down the entitlements that creditors seek to enforce in bankruptcy except as provided by the Bankruptcy Code itself." (P.A.

A-9). The court went on to find that the Trustee bore the ultimate burden of proof, that he had not carried that burden, and that the Department's claim should have been allowed. (P.A. A7-8, 12).

SUMMARY OF ARGUMENT

The burden of proof that applies to tax claims brought in state court also applies to tax claims brought in bankruptcy court. Because rights and obligations adjudicated in bankruptcy come from state law, state law determines the rights of creditors in the assets of a bankruptcy estate. *Butner v. United States,* 440 U.S. 48, 54-55 (1979). One such state law right is the burden of proof applicable to a creditor's claim. Burdens of proof are substantive law, part of the claim itself. The burden of proof from tax law—where proof of a tax assessment usually shifts the burden to the taxpayer to disprove his liability—is accordingly the government's substantive right as a creditor.

The government does not lose that right when it files tax claims in bankruptcy. Although federal interests may displace state law in bankruptcy, the Bankruptcy Code and Rules do not address burdens of proof for claims. Nor is there a bankruptcy policy of "equality of treatment of creditors," as the Trustee asserts, shifting the burden of proof to the government. Bankruptcy policy contemplates only equal *distribution* of assets to similarly situated creditors. This case is about allowance of claims, not distribution of assets. In the allowance of claims, moreover, creditors are treated equally because each is entitled to

assert its state law rights, subject only to the requirements of the Code.

Far from identifying a concrete federal interest that displaces state law, the Trustee's argument for "equality" in the allowance of claims is a thinly-disguised invocation of the bankruptcy courts' equitable powers. The tax law burden of proof, he says, is unfair to private creditors who have no similar right, and bankruptcy courts should be able to level the playing field. Bankruptcy courts, however, can only exercise their equitable powers under the Code itself. They have no power to adopt uniform rules that alter the substantive state law rights of creditors out of a sense of "fairness."

The Trustee's historical argument for altering the burden of proof is equally flawed. First, practice under the former Bankruptcy Act is a tool of statutory construction, not an automatic gap-filler whenever the Code is silent. The Trustee has not asked the Court to construe any provision of the Code. Second, the Trustee has his history wrong. Although Congress increasingly subjected the claims of all creditors to the same *procedural* requirements, there was never a movement to alter government creditors' *substantive* state law rights. Nor was there an established judicial practice under the former Act of assigning to the government the burden of proof for tax claims. Bankruptcy history shows only that Congress has never specified a burden of proof for claims—not under the Act, and not under the Code.

Altering the burden of proof for tax claims will violate bankruptcy policy favoring uniform treatment of property interests between state courts and bankruptcy courts. It

will encourage taxpayers to litigate tax disputes in the bankruptcy courts rather than the state courts, despite Congressional concern that bankruptcy not become a refuge for tax delinquents. And it will disrupt state tax collection and necessitate changes in state tax law, contrary to the "strong background presumption against [federal] interference with state taxation." *National Private Truck Council v. Oklahoma Tax Comm'n,* 515 U.S. 582, 590 (1995). Nothing in federal law or policy compels these drastic results.

ARGUMENT

I. INTRODUCTION

The burden of proof that ordinarily applies to tax claims in state court does not shift to the government in bankruptcy court. The reasons why are not only fundamental but well-established. It is a basic premise of bankruptcy law that state law defines the rights of creditors in a bankruptcy estate. *Butner v. United States,* 440 U.S. 48, 54-55 (1979). It is just as basic that burdens of proof are substantive state law. *Garrett v. Moore-McCormack Co.,* 317 U.S. 239, 249 (1942). The burden of proof from state law is therefore a creditor's substantive right, a right that applies in the bankruptcy court unless some overriding federal interest requires a different result. There is no such federal interest.

The question here is not whether tax creditors like the Illinois Department of Revenue should be given some "advantage" (Pet. Br. at i) or "benefit" (*id.* at 27) in bankruptcy through a particular burden of proof, as the

Trustee asserts. The burden of proof for tax claims originates outside of bankruptcy, and whatever "advantage" tax creditors enjoy as a result is their substantive right under state law. Nor is the question whether creditors should be accorded "equality of treatment." (Pet. Br. at 27). Creditors are already treated equally in the allowance of claims because, except where the Code provides otherwise, all creditors come into bankruptcy with the same rights they had outside of bankruptcy.

The question in this case is whether tax creditors—unlike all other creditors—should be stripped of a substantive non-bankruptcy right and assigned some other, lesser right, when Congress has not seen fit to do so in the Code. The answer is no.

II. THE BURDEN OF PROOF FROM SUBSTANTIVE TAX LAW APPLIES WHEN TAX CLAIMS ARE FILED IN BANKRUPTCY PROCEEDINGS.

A. State Law Governs A Creditor's Rights In Bankruptcy Unless Some Federal Interest Dictates Otherwise.

The rights of creditors outside of bankruptcy are a matter of state law, not federal law. They continue to be a matter of state law in bankruptcy except where a federal interest displaces them.

The bankruptcy laws provide a forum and procedures to address the rights of creditors. *Vanston Bondholders Protective Committee v. Green,* 329 U.S. 156, 171 (1946) (Frankfurter, J., concurring); Alfred Hill, *The Erie Doctrine in Bankruptcy,* 66 Harv. L. Rev. 1013, 1020 (1953). Unless the Code provides otherwise, however, the bank-

ruptcy laws do not create rights. "Parties are in a bankruptcy court with their rights and duties already established, except insofar as they subsequently arise during the course of bankruptcy administration or as part of its conduct." *Vanston,* 329 U.S. at 169 (Frankfurter, J., concurring); *see also Butner,* 440 U.S. at 54; Vern Countryman, *The Use of State Law in Bankruptcy Cases (Part I),* 47 N.Y.U. L. Rev. 407, 412 (1972) (bankruptcy "deals with an existing condition" and does not establish claims).

Because "[p]roperty interests are created and defined by state law," state law, not bankruptcy law, determines the interests of creditors in a bankruptcy estate. *Butner,* 440 U.S. at 54-55. Declaring "the basic federal rule" in bankruptcy to be "that state law governs," *id.* at 57, the Court observed in *Butner* that Congress has not redefined the rights of creditors in the bankruptcy laws but has "generally left the determination of property rights in the assets of a bankrupt's estate to state law," *id.* at 54-55. "Unless some federal interest requires a different result," the Court continued, "there is no reason why such interests should be analyzed differently simply because an interested party is in a bankruptcy proceeding." *Id.*; *see also In re Iowa R.R.,* 840 F.2d 535, 536-37, 539 (7th Cir. 1988) ("state law is the usual source of creditors' rights in bankruptcy cases," and "the bankruptcy court must implement rather than alter them").

Although *Butner* was decided under the former Bankruptcy Act, the Court has adhered to this fundamental view of bankruptcy under the Code. Citing *Butner*, the Court has repeatedly said that the rights of creditors in

the assets of a bankruptcy estate are determined by state law "[i]n the absence of a controlling federal rule," *Nobelman v. American Savings Bank,* 508 U.S. 324, 329 (1993), or "any controlling federal law," *Barnhill v. Johnson,* 503 U.S. 393, 398 (1992); *see also Grogan v. Garner,* 498 U.S. 279, 283 (1991). Unless a federal purpose to displace state law is "'clear and manifest,'" the Court declared recently, "the Bankruptcy Code will be construed to adopt, rather than displace, pre-existing state law." *BFP v. Resolution Trust Corp.,* 511 U.S. 531, 544-45 (1994) (quoting *English v. General Elec. Co.,* 496 U.S. 72, 79 (1990)).

The Trustee, however, disputes the application of state law in this case. Citing *Vanston Bondholders Protective Committee v. Green,* 329 U.S. 156 (1946), he argues that "the allowance" of a claim under section 502 of the Code is "a question of federal law to which federal burdens of persuasion should apply." (Pet. Br. at 24).

The Trustee misinterprets *Vanston*. The statements in the opinion suggesting that the "allowance" of claims is a federal matter were made more than 40 years before the Code was enacted, and they must be taken in historical context. Under the Bankruptcy Act, "allowance" and "proof" of claims were distinct concepts. 3A *Collier on Bankruptcy* ¶ 63.05 at 1775-76 (James W. Moore, ed., 14th ed. 1975). Even claims found to exist and deemed proved might still be "disallowed" in whole or in part on an equitable basis. 3 *Collier on Bankruptcy* ¶ 57.14 at 228-33 (James W. Moore, ed., 14th ed. 1977). The equivalent of this pre-Code power is what the Code today terms "equitable subordination." *See* 11 U.S.C. § 510(c)(1);

United States v. Noland, 517 U.S. 535, 538 (1996); *In re Madeline Marie Nursing Homes*, 694 F.2d 433, 437 (6th Cir. 1982).

The courts of appeals have accordingly interpreted the broad language in *Vanston* and in *Pepper v. Litton*, 308 U.S. 295 (1939), to "establish a rule only for the distribution of assets." *Fahs v. Martin*, 224 F.2d 387, 394 (5th Cir. 1955). *Vanston* has "'never been applied . . . to oust state law in the original determination of the existence and amount of liability.'" *In re Highland Superstores, Inc.*, 154 F.3d 573, 578 (6th Cir. 1998) (quoting *In re Madeline Marie Nursing Homes*, 694 F.2d at 437). Indeed, *Vanston* itself explicitly states that "[w]hat claims of creditors are valid and subsisting obligations . . . is to be determined by reference to state law." *Vanston*, 329 U.S. at 161.

This case concerns the validity of a claim, not the distribution of a bankruptcy estate's assets. The validity of a claim is a state law issue, and the rights that government tax creditors assert in bankruptcy proceedings depend on state law. *Vanston*, 329 U.S. at 161; *see also Butner*, 440 U.S. at 55.

B. Burdens Of Proof Are Substantive Law And One Of A Creditor's Non-Bankruptcy Rights.

State law for this purpose includes the burden of proof that applies to a creditor's claim. Burdens of proof are substantive law. The burden of proof under tax law is therefore the government's substantive right.

The burden of proof peculiar to tax law is not just a procedural nicety. The Court has long held that burdens

of proof are substantive law. *See, e.g., American Dredging Co. v. Miller*, 510 U.S. 443, 454 (1994); *Dick v. New York Life Ins. Co.*, 359 U.S. 437, 446 (1959); *Palmer v. Hoffman*, 318 U.S. 109, 117 (1943); *Cities Service Oil Co. v. Dunlap*, 308 U.S. 208, 212 (1939); *see also In re Landbank Equity Corp.*, 973 F.2d 265, 270 (4th Cir. 1992); 1 Wigmore, *Evidence* § 5 at 358 (Tillers rev. 1983) ("burdens of proof and those evidentiary rules thought to affect burdens proof" are "most often treated as substantive"). A party's burden of proof "inhere[s] in his cause of action." *Garrett*, 317 U.S. at 249. It "is part of the very substance of his claim and cannot be considered a mere incident of procedure." *Id.*; *see also Cities Service*, 308 U.S. at 212 (stating that the burden of proof relates to a "substantial right," one on which a party "may confidently rely").

In his brief, the Trustee offers no serious argument that burdens of proof are not substantive law. Instead, he attacks the proposition indirectly, asserting that "bankruptcy courts are not bound under *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938)" and so implying that burdens of proof are only substantive when *Erie* is involved. (Pet. Br. at 22).

The Trustee is mistaken. Although burdens of proof are substantive for purposes of *Erie*, they are not, as the Trustee suggests, substantive because of *Erie*. Burdens of proof are substantive law because so often they turn out to be critical: "In all kinds of litigation it is plain that where the burden of proof lies may be decisive of the outcome." *Speiser v. Randall*, 357 U.S. 513, 525 (1958); *see also American Dredging*, 510 U.S. at 454 (burdens of

proof "bear upon the substantive right to recover"). The critical nature of the burden of proof is what makes it "part of the very substance" of a party's claim. *Garrett*, 317 U.S. at 249; *see also* 9 Charles Alan Wright & Arthur R. Miller, *Federal Practice & Procedure* § 2408 at 555 (1995) (burdens are a "matter of substance" because they are "associated closely with substantive rights").

The Court has never confined its view that burdens of proof are substantive to cases involving *Erie* questions, making burdens of proof substantive for *Erie* purposes but procedural for others. In *Garrett*, for example, the Court held that because burdens of proof are substantive law, the burden of proof on a federal claim applies when the claim is brought in state court. *Garrett*, 317 U.S. at 249; *see also Central V. Ry. v. White*, 238 U.S. 507, 511-12 (1915) (same). Recently, the Court again declared—without any sort of *Erie* qualification—that "the assignment of the burden of proof is a rule of substantive law." *Director v. Greenwich Collieries*, 512 U.S. 267, 271 (1994).

As the Seventh Circuit correctly noted, "the general pattern of American tax law" is to place the burden on the taxpayer to disprove his liability. (P.A. A-10). "[T]he usual procedure for the recovery of debts is reversed in the field of taxation. Payment precedes defense, and the burden of proof, normally on the claimant, is shifted to the taxpayer." *Bull v. United States*, 295 U.S. 247, 260 (1935); *see also United States v. Janis*, 428 U.S. 433, 441 (1976) (calling this "the usual rule with respect to the burden of proof in tax cases"); *Helvering v. Taylor*, 293 U.S. 507, 515 (1935). Both federal tax law, *see* Leo P. Martinez, *Tax Collection and Populist Rhetoric: Shifting the Burden of Proof in Tax Cases*, 39 Hastings L.J. 239, 257 (1988), and state tax law, *see* Amicus Br. of State of New Mexico, et al., in Support of Cert. Pet. at 6 and n.3, typically allocate the burden of proof to the taxpayer.[5]

More than other burdens of proof, the tax law burden of proof "inheres" in the government's tax claim because of the claim's nature and its importance. *Garrett*, 317 U.S. at 249; *see Delaney v. Comm'r*, 99 F.3d 20, 23 (1st Cir. 1996) (tax law burden of proof is "more deeply rooted than the conventional regimen that places the burden of proof on the moving party"). The burden of proof directly advances the government's vital interest in securing revenue essential for government operations. Taxes are "the life-blood of government, and their prompt and certain availability an imperious need." *Bull*, 295 U.S. at 259; *see also United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 734 (1979). As a consequence, the government must resort to "more drastic means of collection" than other creditors, including a burden-shifting scheme under which the taxpayer must prove the government's assessment wrong. *Bull*, 295 U.S. at 259-60.

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[5] The Internal Revenue Service Restructuring and Reform Act of 1998, Pub. L. No. 105-206, altered federal tax law to place the burden of proof on the Internal Revenue Service. *See* 26 U.S.C. § 7491(a). That section, however, requires that several prerequisites be met before the burden shifts from the taxpayer to the I.R.S. *Id.* Because of these prerequisites, the extent to which section 7491(a) has any practical impact has been questioned. *See* Steve R. Johnson, *The Dangers of Symbolic Legislation: Perceptions and Realities of the New Burden-of-Proof Rules*, 84 Iowa L. Rev. 413 (1999).

The tax law burden of proof also stems from a recognition that state and federal tax systems depend on voluntary compliance by taxpayers rather than government enforcement. *See United States v. Bisceglia*, 420 U.S. 141, 144 (1975); *United States v. Generes*, 405 U.S. 93, 104 (1972). Under state and federal law, taxpayers are obligated to perform their own assessment and "disclose honestly all information relevant to tax liability." *Bisceglia*, 420 U.S. at 144. This obligation includes maintaining records that will enable taxpayers to make that disclosure. *See Spies v. United States*, 317 U.S. 492, 495 (1943) (a self-assessment system functions only when taxpayers "keep and render true accounts"). Taxpayers bear the burden of proof because they are more likely than the government to have information about their liabilities. *United States v. Rexach*, 482 F.2d 10, 16 (1st Cir. 1973).

The burden of proof under tax law, in short, is no "mere incident of procedure," *Garrett*, 317 U.S. at 249, but is an integral part of tax law, as much the government's right as the right to levy the tax itself. The state law burden of proof therefore applies in bankruptcy unless the Trustee shows "some federal interest" in displacing state law in tax cases, *Butner*, 440 U.S. at 55, an interest "clear and manifest" from federal law, *BFP*, 511 U.S. at 544; *cf. Grogan*, 498 U.S. at 283 (standard of proof governing "[t]he validity of a creditor's claim," as opposed to its dischargeability, is "determined by rules of state law").

C. No Federal Interest Displaces The State Law Burden Of Proof For Tax Claims.

The Trustee has shown no such federal interest. The Bankruptcy Code and the Rules of Bankruptcy Procedure say nothing about burdens of proof in claims objection proceedings, and, despite what the Trustee claims, there is no general bankruptcy policy of "equality of treatment of creditors" (Pet. Br. at 27), particularly none concerning allowance of claims. Far from displacing state law, federal bankruptcy policy and federal policy toward state tax administration weigh heavily in favor of employing the state law burden of proof.

1. The Bankruptcy Code And Rules Establish No Burdens Of Proof For The Allowance Of Claims.

Although the obvious source of a "federal interest" displacing state law would be federal bankruptcy law itself, bankruptcy law does not provide one. Nothing in the Bankruptcy Code sets burdens of proof for any claims, let alone alters the state law burden of proof for tax claims. Section 502 of the Code provides for the proof and allowance of claims, 11 U.S.C. § 502, and section 505(a) allows the bankruptcy courts to "determine the amount or legality of any tax," 11 U.S.C. § 505(a). Neither provision, however, addresses burdens of proof. Nor does any other section of the Code. *See Landbank*, 973 F.2d at 270-71; *Final Report of the National Bankruptcy Review Commission* 3.2.5 (Oct. 20, 1997), *reprinted in* vol. G *Collier on Bankruptcy* app. pt. 44 at 44-810 (Lawrence P. King, ed., rev. 15th ed. 1999) ("*Final*

Report"). The Trustee admits as much in his brief. (Pet. Br. at 8, 15, 17).

This omission was intentional. Elsewhere in the Code, Congress explicitly addressed burdens of proof. *See* 11 U.S.C. § 362(g) (relief from automatic stay); 11 U.S.C. § 363(o) (adequate protection); 11 U.S.C. § 364(d)(2) (adequate protection); 11 U.S.C. § 547(g) (avoidability of preferential transfer); 11 U.S.C. § 1129(d) (confirmation of plan for purpose of avoiding taxes). Although Congress could have established a burden of proof for claims, as well, it did not do so, and the Senate and House Reports explain the omission: "The burden of proof on the issue of allowance is left to the Rules of Bankruptcy Procedure." S. Rep. No. 95-989, 95th Cong., 2nd Sess. 62, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5848; H.R. Rep. No. 95-595, 95th Cong., 2nd Sess. 352, *reprinted in* 1978 U.S.C.C.A.N. 5973, 6308.

But the Bankruptcy Rules assign no burdens of proof for claims either, something the Trustee also admits. (Pet. Br. at 8). Like the Code, the Rules set certain burdens of proof. *See* Fed. R. Bankr. P. 4003(c) (objection to exemption); Fed. R. Bankr. P. 4005 (objection to discharge). For claims, though, Rule 3001(f) states only that a proof of claim is "prima facie evidence of the validity and amount of the claim." Fed. R. Bankr. P. 3001(f). The Rule "does not, in a technical sense, allocate [the] burden of proof" but "simply establishes that a proof of claim constitutes evidence." *In re Cobb*, 135 B.R. 640, 641 (Bankr. D. Neb. 1992); *see also Thinking Machines Corp. v. New Mexico Taxation & Revenue Dep't*, 211 B.R. 426, 428, 430 n.5 (D. Mass. 1997); *In re Ford*, 194 B.R. 583, 589 (S.D. Ohio 1995). If Congress considers that a deficiency, it has never sought to remedy it in the Code.[6]

With the Bankruptcy Code and Rules silent on the matter, there is no "controlling federal law," *Barnhill*, 503 U.S. at 398, or "controlling federal rule," *Nobelman*, 508 U.S. at 329, that displaces the state law burden of proof.

2. The Trustee Identifies No Other Federal Interest That Displaces The Tax Law Burden Of Proof.

Unable to come up with any "federal rule" or "law," the Trustee contends that giving tax creditors the "benefit" of a burden of proof that other creditors do not enjoy is contrary to bankruptcy's "fundamental goal" of "equality of treatment of creditors." (Pet. Br. at 27). This is especially so, he says, given that tax claims already receive priority in distribution. (*Id.*).

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[6] In 1997, the National Bankruptcy Review Commission in fact recommended that Congress amend the Bankruptcy Code "to clarify" that the tax law burden of proof is "equally applicable in bankruptcy court proceedings to determine tax liabilities under 11 U.S.C. §§ 502 and 505." *Final Report, supra*, at 44-806. The Commission's recommendation was consistent with the views of commentators who have advocated applying the non-bankruptcy burden in bankruptcy cases. *See, e.g.*, 15 *Collier on Bankruptcy* ¶¶ TX5.03[5], TX5.04[6] (Lawrence P. King, ed., rev. 15th ed. 1999); C. Richard McQueen & Jack F. Williams, *Tax Aspects of Bankruptcy Law and Practice* § 7:25 (3rd ed. 1997).

The Trustee is wrong for two reasons. First, he grossly overstates the extent to which the bankruptcy laws are designed to achieve "equal treatment." Bankruptcy does not serve as the great leveler, and no bankruptcy principle calls for formal equality among creditors in all things. *See* Frances R. Hill, *Toward A Theory of Bankruptcy Tax: A Statutory Coordination Approach*, 50 Tax Law. 103, 162 (1996) ("[I]t is far from clear that formal equality is a principle of fairness in disputes among creditors"). The policy to which the Trustee refers is one of "equality of *distribution* among all creditors." H.R. Rep. No. 95-595, *supra*, at 186, *reprinted in* 1978 U.S.C.C.A.N. 5973, 6147 (emphasis added); *see also Landbank*, 973 F.2d at 270. Once claims are allowed, in other words, "creditors of equal priority should receive pro rata shares of the debtor's property." *Begier v. I.R.S.*, 496 U.S. 53, 58 (1990).

As the Department has observed, however, this case does not concern what assets should be distributed to creditors with allowed claims. It concerns whether the Department's claim should have been allowed in the first place. In suggesting that a policy of "equality" underlies the process governing the allowance of claims, the Trustee confuses two different stages of a bankruptcy proceeding.[7] *See* Thomas H. Jackson, *Bankruptcy, Non-*

[7] Even the policy with respect to distribution is not one of perfect equality. It is a "general policy" subject to exceptions, including "the grant of priority to certain claims" and "the subordination of certain claims." H.R. Rep. No. 95-595, *supra*, at 186, *reprinted in* 1978 U.S.C.C.A.N. 5973, 6147. At the dis-

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Bankruptcy Entitlements, and the Creditors' Bargain, 91 Yale L.J. 857, 859 (1982) (the assertion that "equality" is an overriding bankruptcy policy does not deal, "even roughly, with the plain fact that all bankruptcy laws to date accord substantial respect to non-bankruptcy entitlements").

Second, in the allowance of claims all creditors—private creditors and the government—*are* treated equally under the Code in an important sense. Except where Congress has expressly chosen to change substantive rights, all parties come into bankruptcy with the same rights and entitlements they had outside of bankruptcy. *See Butner*, 440 U.S. at 54-55, 57. All creditors are treated identically because the position they held is neither improved nor worsened, and the strength of their claims is neither increased nor decreased. In asking the Court to disturb the state law rights of government creditors by adopting a less favorable burden of proof for tax claims, the Trustee is not seeking equal treatment for non-governmental creditors. He wants better treatment.

[7] (...continued)
tribution stage, the government has historically enjoyed a favored status and continues to do so under the Code: tax claims are priority claims, 11 U.S.C. § 507(a)(8), and are non-dischargeable, 11 U.S.C. § 523(a)(1). The "egalitarian appeal" of the Trustee's argument "overlooks the frequent disparate treatment of the government as tax-creditor found in the Bankruptcy Code regarding such matters as the priority and dischargeability of claims." 15 *Collier on Bankruptcy*, *supra*, ¶ TX5.03[5] at TX5-25.

The Seventh Circuit rightly saw the Trustee's appeal to "equality of treatment" for what it is: an argument for the intervention of equity in the allowance of claims. (P.A. A-9-10). No such equitable authority exists. Although the Trustee in his brief continues to play up the equitable powers of bankruptcy courts (Pet. Br. at 28 and n.11), the Bankruptcy Code "does not authorize free-wheeling consideration of every conceivable equity." *N.L.R.B. v. Bildisco & Bildisco,* 465 U.S. 513, 527 (1984). Rather, the equitable powers of bankruptcy courts can only be exercised under the Code itself. *Norwest Bank Worthington v. Ahlers,* 485 U.S. 197, 206 (1988).

No Code provision authorizes bankruptcy courts to discount or even discard the state law rights of an entire class of creditors on equitable grounds, allowing the claims of some creditors and not others because some creditors are perceived to be "most worthy." *In re Milwaukee Cheese Wisconsin, Inc.,* 112 F.3d 845, 848 (7th Cir. 1997). "Undefined considerations of equity," the Court declared in *Butner*, do not entitle bankruptcy courts to fashion "uniform federal rule[s]" that rob creditors of their rights under state law.[8] *Butner,* 440 U.S. at 56; *see also Noland,* 517 U.S. at 540-41; *In re Highland*

[8] In contending that tax creditors should be deprived of state law rights when other creditors are accorded theirs, the Trustee is in fact advocating, not equity, but inequity. *See Butner,* 440 U.S. at 56 (conferring new rights on some creditors and negating the rights of others "when bankruptcy intervenes" is an "inequity"); *Iowa R.R.,* 840 F.2d at 536 (equity means "the consistent application of legal rules," and "[w]hen one claimant gets treatment that is denied to others, they have been treated inequitably") (internal quotation omitted).

Superstores, 154 F.3d at 578-79; *In re Lapiana,* 909 F.2d 221, 224 (7th Cir. 1990) ("bankruptcy judges are not empowered to dissolve rights in the name of equity").

As for the advantages tax creditors have over other creditors, those are advantages the law gives them. The "benefit" tax creditors reap from their burden of proof (Pet. Br. at 27) is one state law confers. Tax claims receive priority in bankruptcy because Congress said so in the Code. 11 U.S.C. § 507(a)(8). In drafting the Code, Congress specifically sought to balance the competing interests of debtors, private creditors and tax creditors. *See* S. Rep. No. 95-989, *supra*, at 14, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5800; *Landbank,* 973 F.2d at 270. Congress knew how to address taxes and burdens of proof, and Congress could have displaced the state law burden of proof for tax claims in the Code. It chose not to. Bankruptcy courts may not second-guess that choice, disfavoring tax creditors on the ground that "Congress has given them too much." *Thinking Machines,* 211 B.R. at 431 n.7 (internal quotation omitted).

The Trustee also mistakenly suggests that the "policy reasons" for placing the burden of proof on the taxpayer would not be "disserved" by reversing the burden of proof in bankruptcy. He asserts that trustees and private creditors "often" have no better understanding of the debtor's affairs and no more access to information than the government. (Pet. Br. at 27 n.10).

In most cases, though, trustees and creditors do have information about the debtor. Private creditors, who often insist on financial information as a condition of doing business, are in fact more likely to have infor-

mation than the government, which deals with the debtor on a non-consensual basis. The Code and Rules also give trustees and creditors committees the means to acquire information, authorizing them to investigate the debtor's finances, *see* 11 U.S.C. § 704(4); 11 U.S.C. § 1103(c)(2); 11 U.S.C. § 1302(b)(1), and to "examine any entity" concerning "the liabilities and financial condition of the debtor," Fed. R. Bankr. P. 2004(a), (b). *See also* 15 *Collier on Bankruptcy, supra,* ¶ TX5.03[5] at TX5-25 n.57 (noting that arguments of the kind the Trustee makes for shifting the burden of proof to the government "overlook the trustee's rights to the relevant books and records").

Moreover, access to information is not the only "policy reason" underlying the tax law burden of proof. Tax law also assigns the burden of proof to taxpayers to provide an incentive to meet their record-keeping obligations in a tax system based on voluntary compliance and self-assessment. *Rexach,* 482 F.2d at 16. Removing the burden of proof from taxpayers would destroy that incentive. *Barrows v. I.R.S.,* 231 B.R. 446, 452 (D.N.H. 1998); *Thinking Machines,* 211 B.R. at 431. The risks from a scarcity of information would fall on the government, not the taxpayer, and a taxpayer who kept few or no tax records would be rewarded by escaping liability.[9] *Rexach,*

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[9] It is no answer to argue that under 11 U.S.C. § 727(a)(3) a debtor who fails to keep records may be denied a discharge. (Pet. Br. at 27 n.10). Records sufficient for bankruptcy proceedings will not necessarily be records sufficient for taxing authorities to prove their claims. Nor are the Code's record-keeping requirements as strict as the requirements of tax law.
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482 F.2d at 17 (placing the burden on the government would undermine record-keeping requirements, making the government's case "more difficult if not impossible to establish").

These considerations, however, go to choices about policy—whether assigning the burden of proof to the government in bankruptcy would be a more sensible practice. That is not the question here. Congress enacted the Code, and suggestions about the best way to operate the bankruptcy system should be addressed to Congress rather than the Court. *See Kawaauhau v. Geiger,* 523 U.S. 57, 64 (1998) (bankruptcy policy is for Congress, not the Court, to decide). The only question in this case is whether any clear and manifest federal interest requires bankruptcy courts faced with tax claims to alter the burden of proof applicable to those claims under state law. *See Butner,* 440 U.S. at 55.

The Trustee has proposed no such federal interest. It is not enough to say that other creditors do not have the same rights as tax creditors, when the rights of all

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[9] (...continued)
Under section 727(a)(3), a credible excuse for the loss of records will often ensure a discharge, *see, e.g., In re Pisano,* 105 B.R. 125, 127 (Bankr. S.D. Fla. 1989) (debtor's unrebutted testimony that moving company lost carton of records deemed sufficient), whereas the loss of records is rarely a defense to tax liability, *see Andrew Crispo Gallery, Inc. v. Comm'r,* 16 F.3d 1336, 1343 (2nd Cir. 1994). Some debtors (consumer debtors, for example) are not even expected to have much in the way of records and generally are not denied a discharge under section 727(a)(3). *See* 6 *Collier on Bankruptcy* ¶ 727.03[3][g] at 727-36 (Lawrence P. King, ed., rev. 15th ed. 1999).

creditors are a matter of state law. *Butner,* 440 U.S. at 54. No bankruptcy policy is thwarted simply because state law gives one creditor greater rights than another. *In re Anchorage Int'l Inn, Inc,,* 718 F.2d 1446, 1451 (9th Cir. 1983).

3. Federal Policies Support The Use Of The State Law Burden Of Proof In Bankruptcy.

Not only has the Trustee identified no federal interest supporting the result the advocates, but several federal policies militate against altering the burden of proof when a taxpayer files bankruptcy.

First, shifting the burden of proof contravenes bankruptcy's neutral stance toward non-bankruptcy rights and the "uniform treatment of property interests" it ensures. *Butner,* 440 U.S. at 44; *see also Patterson v. Shumate,* 504 U.S. 753, 764 (1992) (stating that "treatment of pension benefits" should not "vary based on the beneficiary's bankruptcy status"). For the most part, bankruptcy neither confers new rights nor takes away old ones. If the burden of proof changes when taxpayers file bankruptcy, however, taxing authorities will be denied one of their non-bankruptcy rights. Taxpayers, meanwhile, will obtain a right they do not have when their tax liabilities are decided in state court. No party should receive "'a windfall merely by reason of the happenstance of bankruptcy.'" *Butner,* 440 U.S. at 55 (quoting *Lewis v. Manufacturers Nat'l Bank,* 364 U.S. 603, 609 (1961)). Nor should the rights of parties in tax disputes turn on whether the disputes are litigated in bankruptcy court or state court. *Ford,* 194 B.R. at 589-90.

Second, the bankruptcy laws are meant to discourage taxpayers from forum-shopping and from using bankruptcy "as a means of improperly avoiding their tax debts." S. Rep. No. 95-989, *supra,* at 14, *reprinted in* 1978 U.S.C.C.A.N. 5787, 5800. Congress specifically intended "to make tax considerations as nearly neutral as possible with regard to whether a taxpayer should file a case under chapter 11." 15 *Collier on Bankruptcy, supra,* ¶ TX5.04[6] at TX 5-46; *see Butner,* 440 U.S. at 55 (uniform treatment of property interests serves to "discourage forum shopping"). If taxpayers can shift the burden of proof to the government merely by filing bankruptcy, however, bankruptcy proceedings will provide taxpayers with their best chance of avoiding tax liabilities. Taxpayers will quickly learn that they are better off defending tax claims in bankruptcy court than in state court, giving them an incentive to file bankruptcy and "funnel[ling] people with tax problems into the bankruptcy courts." *Thinking Machines,* 211 B.R. at 431.

Third, shifting the burden of proof to the government in bankruptcy would be contrary to fundamental principles of federalism. The power to tax is not only an aspect of state sovereignty but "is basic to the power of the State to exist." *Arkansas v. Farm Credit Servs.,* 520 U.S. 821, 826 (1997). Because of the importance of tax laws to the states, *Fair Assessment in Real Estate Ass'n v. McNary,* 454 U.S. 100, 108 (1981), Congress and the Court "repeatedly have shown an aversion to federal interference with state tax administration." *National Private Truck Council v. Oklahoma Tax Comm'n,* 515 U.S. 582, 586 (1995). They have recognized that federal intervention in state tax matters risks throwing state tax administration

"'into disarray,'" allowing taxpayers to escape the requirements of state law. *Rosewell v. LaSalle Nat'l Bank*, 450 U.S. 503, 527 (1981) (quoting *Perez v. Ledesma*, 401 U.S. 82, 128 (1971) (Brennan, J., concurring in part and dissenting in part)).

If the burden falls on the government to prove tax liability, state tax administration could be disrupted, and states could find it necessary to rework their tax laws. Because taxpayers will be able to contest their tax liabilities in a forum where they are relieved of the obligation to produce evidence, potential tax delinquents will no longer have much reason to maintain records. To compensate, states could well be forced to impose greater reporting requirements on all taxpayers, burdening them and intruding more deeply into their lives. Rather than chance revenue shortfalls, states may have to create new and expensive mechanisms for the sole purpose of ferreting out information that taxpayers previously had to supply themselves or risk tax liability if they did not. In that event, the states' costs of collection will increase; their net tax revenues will decrease.

Given the "strong background presumption against interference with state taxation," *National Private Truck Council*, 515 U.S. at 590, the policy of treating property interests in and out of bankruptcy uniformly, and the Congressional concern that bankruptcy not become a haven for tax delinquents, Congress could not have meant for tax claims to be determined in bankruptcy using a burden of proof different from the burden of proof in state court.

III. THE TRUSTEE'S HISTORICAL APPROACH IS NO SUBSTITUTE FOR THE ANALYSIS *BUTNER* REQUIRES.

In his brief, the Trustee spends little time proposing a federal interest that warrants displacing the state law burden of proof. Although *Butner* describes the applicable analysis, the Trustee barely mentions the case. (*See* Pet. Br. at 26). Rather than confront *Butner* and make the showing that decision requires, the Trustee tries to sidestep the issue, embarking on a lengthy excursion into bankruptcy history designed to preempt *Butner* altogether. (Pet. Br. at 9-20).

The problem with the Trustee's historical argument—an argument he has never made before in this litigation—is that both its premises are false. The history of the bankruptcy laws provides no basis for inserting burdens of proof to fill gaps in the Code. And even if past practice could be used this way, the Trustee's version of bankruptcy history is incorrect.

A. Past Practice Under The Bankruptcy Act Is An Aid To Construction, Not A Way Of Filling Gaps In The Code.

Federal common law under the Bankruptcy Act does not mechanically supplement the Code in all matters where the Code is silent, as the Trustee seems to believe. It is simply an aid to construction when Code provisions are unclear. Because no Code section addresses burdens of proof for claims, there is no Code section to be construed here. The history of bankruptcy practice is beside the point.

Although the Court has often examined practices under the Act in cases arising under the Code, it has done so only in the course of considering what existing Code provisions mean. *See, e.g., Cohen v. De La Cruz,* 523 U.S. 213, 221-22 (1998) (noting that history of fraud exception under the Act "reinforces our reading of § 523(a)(2)(A)"); *Noland,* 517 U.S. at 539 (considering past equitable subordination practice in interpreting section 510(c)); *United Savings Ass'n v. Timbers of Inwood Forest Assoc., Ltd.,* 484 U.S. 365, 373 (1988) (considering former practice where legislative history indicated section 506(b) "merely codified pre-Code bankruptcy law"); *Kelly v. Robinson,* 479 U.S. 36, 44, 47, 50 (1986) (considering "the language of §§ 101 and 523 in light of the history of bankruptcy court deference to criminal judgments" because that history "informs our understanding of the language of the Code"); *Midlantic Nat'l Bank v. New Jersey Dep't of Envtl. Protection,* 474 U.S. 494, 501 (1986) (reviewing history of abandonment power as an aid to interpreting section 554).

Past bankruptcy practice, in other words, has served as a tool of statutory interpretation. *United States v. Ron Pair Enters., Inc.,* 489 U.S. 235, 244-45 (1989) (explaining that in *Kelly* and *Midlantic*, for example, the Court "looked to pre-Code practice for interpretive assistance" where statutory language, "at least to some degree, was open to interpretation"). When Code provisions are ambiguous or unclear, Congress is assumed to have been aware of accepted practices under the Act and to have drafted the Code with them in mind. *Kelly,* 479 U.S. at 47; *Midlantic,* 474 U.S. at 501. This is no more than an application of "the normal rule of statutory construction"

that "if Congress intends for legislation to change the interpretation of a judicially created concept, it makes that intent specific." *Midlantic,* 474 U.S. at 501.

The Court has not said, however, that it will automatically import "established practice" under the Act to fill every gap in the Code when no question of statutory meaning is at stake. *See Ron Pair,* 489 U.S. at 244 (in determining that Congress intends no departure from pre-Code practice, the Court has not simply relied "on a pale presumption to that effect"). To the contrary, the Court has made clear that it will not "adopt a court-made rule to supplement federal statutory regulation that is comprehensive and detailed." *O'Melveny & Myers v. F.D.I.C.,* 512 U.S. 79, 85 (1994); *see also Atherton v. F.D.I.C.,* 519 U.S. 213, 218-19 (1997). Instead, "matters left unaddressed in such a scheme are presumably left subject to the disposition provided by state law." *O'Melveny,* 512 U.S. at 85.

Federal common law may displace state law to fill gaps in a federal statutory scheme, but it does so only in instances when there is "'a significant conflict between some federal policy or interest and the use of state law.'" *Atherton,* 519 U.S. at 218 (quoting *O'Melveny*, 512 U.S. at 87). Those instances are "'few and restricted.'" *O'Melveny,* 512 U.S. at 87 (quoting *Wheeldin v. Wheeler,* 373 U.S. 647, 651 (1963)). Where the Bankruptcy Code is concerned, the Court has said, the statutory scheme will generally be construed "to adopt, rather than displace, pre-existing state law." *BFP,* 511 U.S. at 545.

The Trustee has not identified a Code provision he wants the Court to construe. He admits there is none. (Pet. Br. at 7-8, 15). Without such a provision, *O'Melveny*,

Atherton and *BFP* demand a conflict with "some federal policy or interest" before state law can be discarded—bringing the analysis back to *Butner*. *See Iowa R.R.*, 840 F.2d at 540. What past practices were under the Bankruptcy Act is irrelevant.

B. There Was No Accepted Judicial Practice Under The Act Of Placing The Burden Of Proof On Tax Creditors.

Even if past bankruptcy practices were relevant here, the Trustee has his history wrong. The trend in bankruptcy legislation over the last century was to subject the government as creditor to the same *procedures* in bankruptcy as other creditors, not to disrupt the government's *substantive* rights. The courts, meanwhile, had no established practice in bankruptcy cases of placing the burden of proof on the government in tax claims.

Changes in the bankruptcy laws since the 1898 Act was enacted do not show a Congressional desire to alter the non-bankruptcy rights of government creditors. It is true that taxes were not treated as claims under the original version of the Act but were obligations the trustee had to seek out and pay unless the bankruptcy court issued a bar order. *See* 3 *Collier on Bankruptcy, sup*[illegible], ¶ 57.30 at 433. It is true, as well, that the Chandler Act brought government claims, tax and otherwise, under the Act, requiring that they be filed and proved in the same manner as other claims.[10] *Id.* at 433-44; *see* S. Rep. No. 1916, 75th

[10] "Proving" a claim under section 57a of the Act (and later under former Bankruptcy Rule 301(a)) had nothing to do with
(continued...)

Cong., 3rd Sess. 2, 5 (1938); *In re Berkshire Hardware Co.*, 39 F. Supp. 663, 667 (D. Mass. 1941).

But these were procedural requirements. The purpose of the Chandler Act was to subject government claims to "substantially the same formalities and time limitations as other provable debts." 3A *Collier on Bankruptcy, supra,* ¶ 63.26 at 1900. In matters of bankruptcy procedure, the Chandler Act ensured that a government tax claimant was "in no better position than any other claimant," *In re Ward,* 131 F. Supp. 387, 395 (D. Colo. 1955), and in this respect tax claims were indeed to be treated "no differently from other claims." (Pet. Br. at 11). Thus, in *New York v. Saper,* 336 U.S. 328, 337 (1949), which the Trustee cites, the Court held that government creditors had no more right to post-petition interest—a matter of bankruptcy law—than any other creditor. *Id.* at 337; *see also Nicholas v. United States,* 384 U.S. 678, 683 (1966) (disallowing post-petition interest on post-petition tax liabilities).

Nothing in the Bankruptcy Act or in the Chandler Act, however, purported to alter the substantive, non-bankruptcy rights of tax creditors—the rights on which their claims in bankruptcy were based. It was instead well established under the Act that state law, not bankruptcy

[10] (...continued)
burdens or standards of proof. It meant supplying a statement setting forth the claim, listing any payments made on it, and declaring that the debtor owed the balance. *See* 11 U.S.C. § 93a (repealed); *In re Two Rivers Woodenware,* 199 F. 877, 881 (7th Cir. 1912) (stating that "[s]ection 57a shows how a claim is to be 'proved.'").

law, governed the substantive rights of creditors. As the Court observed: "[w]hat claims of creditors are valid and subsisting obligations against the bankrupt at the time a petition in bankruptcy is filed, in the absence of overruling federal law, is to be determined by reference to state law." *Vanston,* 329 U.S. at 161.

This rule, reiterated in *Butner* more than 50 years later, was consistently applied under the Act. *See, e.g., Security Mortgage Co. v. Powers,* 278 U.S. 149, 153 (1928) (validity of attorney's lien in bankruptcy "must be determined by Georgia law"); *Benedict v. Ratner,* 268 U.S. 353, 359 (1925) (rights of claimant in bankruptcy depended "primarily upon the law of New York"); *Bryant v. Swofford Bros. Dry Goods Co.,* 214 U.S. 279, 291 (1909) ("in bankruptcy the construction and validity" of a contract "must be determined by the local laws of the State"); *see also* 3A *Collier on Bankruptcy, supra,* ¶ 63.07 at 1806-07 (noting that "[t]his principle has always been recognized" under the Act).

Nor did the Act address burdens of proof for claims—something the Trustee concedes—let alone the burden of proof for tax claims. (Pet. Br. at 12). *Whitney v. Dresser,* 200 U.S. 532 (1906), established no burden of proof. The Court held only that a proof of claim was "*prima facie* evidence of its allegations in case it is objected to," adding that this was "not a question of the burden of proof in a technical sense—a burden which does not change whatever the state of the evidence—but simply whether the sworn proof is evidence at all." *Id.* at 534-35. Section 57a of the Bankruptcy Act, 11 U.S.C. § 93a (repealed), and later former Bankruptcy Rule 301(b), only codified this decision.

Against this backdrop, the majority of lower federal court decisions considering tax claims in bankruptcy in fact employed the burden of proof from state or federal substantive tax law.[11] That, not the application of some

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[11] *See, e.g., In re Fox,* 609 F.2d 178, 181 (5th Cir. 1980) (debtor had burden of proving right to state sales tax deductions); *In re Uneco, Inc.,* 532 F.2d 1204, 1207 (8th Cir. 1976) (trustee had burden of proving bad debt deduction); *Paschal v. Blieden,* 127 F.2d 398, 401 (8th Cir. 1942) (trustee had burden of proof to show assessment incorrect); *United States v. Knox-Powell-Stockton Co.,* 83 F.2d 423, 425 (9th Cir. 1936) (trustee had burden of proving monies received were not income); *In re Lang Body Co.,* 92 F.2d 338, 341 (6th Cir. 1937) (trustee had burden of proving taxes were arbitrary and had to meet non-bankruptcy standard of proof); *In re Canady,* 43 A.F.T.R.2d (RIA) 472 (N.D. Ga. 1978) (non-bankruptcy burden of proof applied to objection to tax claim); *In re Menefee,* 40 A.F.T.R.2d (RIA) 5006 (E.D. Mo. 1977) (debtor had burden of proof on I.R.S. counterclaim); *In re Certified Credit Corp.,* 329 F. Supp. 1402, 1403 (S.D. Ohio 1971) (trustee had burden of proving right to deductions); *In re Standard Milling Co.,* 324 F. Supp. 386, 390 (N.D. Tex. 1970) (trustee had burden of proving property tax valuation was excessive under state law); *In re Reeves,* 25 A.F.T.R.2d (RIA) 761 (D. Colo. 1970) (trustee had burden of proof in dispute over I.R.S. assessment); *In re Oxford Assoc.,* 209 F. Supp. 242, 244-45 (D.N.J. 1962) (trustee had burden of proof in tax dispute); *In re Ward,* 131 F. Supp. 387, 390 (D. Colo. 1955) (trustee bore burden of proof on objection to tax claim); *In re Petersilge,* 70 F. Supp. 95, 96-97 (N.D. Ohio 1946) (trustee had burden of proving objection to state sales tax assessment); *In re Garfield Bag & Stationery Co.,* 42 F. Supp. 708, 711 (S.D.N.Y 1941) (trustee had burden to prove deductions under municipal tax ordinance); *In re Lasky,* 38 F. Supp. 24, 30 (N.D. Ala. 1941) (trustee had burden of proving objection

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universal "bankruptcy" burden of proof, appears to have been the established practice. At worst, taking all of the cases the parties have cited, the courts had no consistent practice. But there was certainly no practice of the kind the Trustee claims, one "so widely accepted" as to justify the conclusion that displacing state law burdens was the norm. *Kelly,* 479 U.S. at 46.

In the wake of all this, Congress addressed the burden of proof question in 1978 the same way it had in 1898. It said nothing. As the Department has discussed, and as the Trustee admits, the Bankruptcy Code and Rules contain no burdens of proof for claims.

The Trustee's historical dissertation, then, amounts to little more than this. The Bankruptcy Act created no burden of proof for tax claims, and neither did any of the amendments to the Act. Between 1898 and 1978, federal

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[11] (...continued)
to property tax assessments); *In re Trustees System Co.,* 30 F. Supp. 361, 363 (W.D. Ky. 1939) (debtor had burden of proof in contesting federal income taxes); *In re Mid America Co.,* 31 F. Supp. 601, 607 (S.D. Ill. 1939) (trustee had burden under state law of proving debtor's exemption from state employment taxes); *In re Bell,* 34 F.2d 677, 680 (W.D. Pa. 1929) (trustee had burden of proving right to federal tax deduction), *modified on other grounds sub nom. Jarvis v. Heiner,* 39 F.2d 361 (3rd Cir. 1930); *In re Glover-McConnell Co.,* 9 F.2d 683, 686 (N.D. Ga. 1925) (debtor bore burden of proving entitlement to tax exemption); *In re O'Neill,* 80-2 U.S. Tax Cas. (CCH) ¶ 9716 (Bankr. W.D. Va. 1980) (debtor and trustee had burden of proof in dispute over tax penalty); *In re Osborn,* 4 B.R. 431, 435 (W.D. Mo. 1979) (debtor had burden of disproving liability for federal responsible officer penalty).

courts—to the extent they had a consistent practice at all—employed the burden of proof from substantive tax law in deciding the validity of tax claims. When the Code came into being in 1978, it contained no burden of proof for tax claims, and it still contains none. Neither do the Rules. That is not much of a basis for believing that Congress expects the Court to fashion a special, federal common law burden of proof for tax cases.

The Trustee's historical argument is a clever attempt, not only to avoid *Butner*, but to make it appear that the Department wants special treatment, a dispensation from long-standing rules of bankruptcy. Not so. The long-standing bankruptcy rule is that state law governs the rights of creditors, public and private, except where a federal interest demands otherwise. *Butner,* 440 U.S. at 54-55. In seeking to jettison the state law burden of proof that ordinarily applies to tax claims, the Trustee is the one asking for a special dispensation. To get it, though, the Trustee had to show a clear federal interest compelling that result. *Id.* He has not made that showing.

CONCLUSION

The decision of the United States Court of Appeals for the Seventh Circuit should be affirmed.

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